Supreme Court, U.S.
FILED

971681 APR 14 1998

OFFICE OF THE CLERK

No. 97-_____

IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1997

LYON METAL PRODUCTS, INC., *Petitioner*,

v.

CALIFORNIA BOARD OF EQUALIZATION, *Respondent.*

On Petition for a Writ of Certiorari to the Court of Appeal of the State of California First Appellate District Division Five

PETITION FOR WRIT OF CERTIORARI

MURPHY, HUPP, FOOTE, MIELKE AND KINNALLY
PATRICK M. KINNALLY
8 East Galena Boulevard
Suite 202
P.O. Box 5030
Aurora, IL 60507-5030
Tel.: (630) 844-0056

PILLSBURY MADISON & SUTRO LLP
CRAIG E. STEWART
Counsel of Record
THOMAS V. LORAN III
david p. jedrzejek
235 Montgomery Street
Post Office Box 7880-94120
San Francisco, CA 94120
Tel.: (415) 983-1000

Counsel for Petitioner

45 pp

QUESTION PRESENTED

Under section 6007 of the California Revenue and Taxation Code, local manufacturer/wholesalers such as petitioner Lyon are assessed a sales tax whenever they make a sale to an out-of-state retailer who directs them to "drop ship" the goods (*i.e.*, deliver the goods directly to the retailer's customer) in California. Local wholesalers, however, have no sales tax liability under section 6007 when they act as a drop shipper for in-state retailers. The following question is presented:

> Whether California's drop shipment rule, imposing sales tax liability on wholesalers when they act as drop shippers for out-of-state retailers, but not for in-state retailers, contravenes the Commerce Clause of the United States Constitution.

CORPORATE LISTING

After the action below was filed, petitioner Lyon Metal Products, Inc. became a Delaware limited liability company, and its name was changed to Lyon Metal Products, L.L.C.

Lyon Holding Co. is the parent company of Lyon Metal Products, L.L.C.

The following entities are non-wholly owned subsidiaries of Lyon Metal Products, L.L.C.:

(1) Durand Products, L.L.C.;

(2) Paltier, L.L.C.;

(3) Remline, L.L.C.;

(4) Riverpoint, L.L.C.

(5) Sycamore Systems, L.L.C.;

(6) T & D Metals, L.L.C; and

(7) Targeted Marketing, L.L.C.

TABLE OF CONTENTS

	Page
PETITION FOR WRIT OF CERTIORARI	1
OPINIONS AND ORDERS BELOW	1
JURISDICTION	2
CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED	2
STATEMENT OF THE CASE	3
REASONS FOR GRANTING THE PETITION	6
A. The Drop Shipment Rule as Codified in Section 6007 Presents a Recurrent, Important and Presently Unresolved Federal Question	6
B. The Decision by the Court of Appeal Conflicts with this Court's Commerce Clause Jurisprudence	10
1. Section 6007 discriminates against manufacturers who do business with out-of-state retailers	10
2. The Commerce Clause prevents the imposition of a tax where, as here, there is no nexus between the retail transaction and the taxing State	14

3. As applied, section 6007 is unconstitutional because it creates the potential for multiple taxation 15

CONCLUSION 17

United States Code
Title 28, section 1257 2

1992 Cal. Stat., ch. 902, § 1 3

Other Authorities

2 Hellerstein & Hellerstein, State Taxation, *Drop Shipments*, ¶ 18.07B, S18-16 - S-18-18 (1997/9 Cum. Supp. 8

H. Michael Madsen & Kimberly L. King, *Interstate Dimensions of the Sales Tax: Third-Party Drop Shipments*, 10 State Tax Notes 1233 (April 22, 1996) 8, 9

Rotunda & Nowak, *Treatise on Constitutional Law: Substance and Procedure*, § 13.6, at 272 (2d ed. 1992) 14

Tax Mgmt. (BNA), *Sales and Use Taxes: Drop Shipment Transactions*, §§ 1340.01-.03, pp. 1340.01.C - 1340.03.C 8, 9
§ 1340.05, pp. 1340.05.C.1 - 1340.05.YY.21.C ff 6

IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1997

LYON METAL PRODUCTS, INC., *Petitioner*,

v.

CALIFORNIA BOARD OF EQUALIZATION, *Respondent*.

On Petition for a Writ of Certiorari to the Court of Appeal of the State of California First Appellate District Division Five

---

PETITION FOR WRIT OF CERTIORARI

Lyon Metal Products, Inc. ("Lyon") respectfully petitions for a writ of certiorari to review the judgment and opinion of the Court of Appeal of the State of California, First Appellate District, Division Five.

OPINIONS AND ORDERS BELOW

The order of the Supreme Court of California denying review (App., *infra*, 22a) is unreported. The opinion of the Court of Appeal of California, First Appellate District (App., *infra*, 1a-10a) is reported at 58 Cal.App.4th 906, 68 Cal.Rptr.2d 285 (1997). The statement of decision of the Superior Court of California, City and County of San Francisco (App., *infra*, 11a-21a) is unreported.

JURISDICTION

The judgment of the Court of Appeal was entered on October 24, 1997. On November 18, 1997, the Court of Appeal denied Lyon's timely petition for rehearing. The California Supreme Court denied Lyon's timely petition for review on January 14, 1998 (App., 22a). The jurisdiction of this Court is invoked under 28 U.S.C. § 1257.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Article I, section 8, clause 3 of the United States Constitution confers upon Congress the power to "regulate Commerce . . . among the Several States."

During the relevant period, section 6007 of the California Revenue and Taxation Code provided as follows:

> A "retail sale" or "sale at retail" means a sale for any purpose other than resale in the regular course of business in the form of tangible personal property.
>
> The delivery in this State of tangible personal property by an owner or former owner thereof or by a factor, or agent of such owner, former owner or factor, if the delivery is to a consumer or person for redelivery to a consumer, pursuant to a retail sale by a retailer not engaged in business in this State, is a retail sale in this State by the person making the delivery. He shall include the

retail selling price of the property in his gross receipts.[1]

STATEMENT OF THE CASE

Lyon is a leading manufacturer and wholesaler of steel equipment and office furniture. Reporter's Transcript ("RT") 10:9-11; 10:20. Its principal place of business is located in Aurora, Illinois (Petitioner's Appendix ("PA") 97), but Lyon maintains sales personnel in California and a warehouse in the City of Industry, California. RT 17:1-8.

On August 14, 1994, respondent California Board of Equalization (the "Board") issued a tax deficiency notice to Lyon under California Revenue and Taxation Code section 6007.[2] Respondent's Appendix ("RA") 11. The notice was for non-payment of sales tax based on eleven drop shipment sales made by Lyon to out-of-state retailers between 1987 and 1990. RT 11:3-17; PA 1.

In each of the eleven drop shipment sales, the retailer, an out-of-state dealer, contracted with Lyon to purchase goods for resale. RT 20:28-21:1. In each sale, Lyon agreed, for the convenience of the retail dealers and their customers, to ship the goods directly from its warehouse in Industry, California to the dealers' customers located within California.

---

[1] Non-substantive, editorial amendments were made to section 6007 in 1992. 1992 Cal. Stat., ch. 902, § 1. Respondent's tax treatment of drop shipments under the amended statute remains the same. Thus, the Court of Appeal relied on the amended statute in reaching its decision below. App., 3a.

[2] Unless otherwise indicated, all statutory references are to the California Revenue and Taxation Code.

RT 16:2-22. All deliveries were made by common carrier F.O.B. Lyon's plant in Industry. RT 16:23-17:11.

Lyon and its dealers dealt at arms' length and for their respective accounts and did not act as each other's agent. RT 18:19-26. Lyon was not involved in negotiating, and did not in fact know, the terms or price of its dealers' resales of the goods to their customers in California. RT 15:19-16:1.

As the trial court found (RA 91:10-15), the evidence was uncontroverted at trial that all of the transactions involved sales by Lyon for resale. Hence, none was a "retail sale" within the meaning of the first paragraph of section 6007. Moreover, the Board admitted that all of the Lyon dealers were "retailers." PA 67, 72.

After paying $17,413.86 for the alleged sales tax deficiency (PA 101, ¶ 13, RA 20) and exhausting administrative remedies (PA 107-114), Lyon timely filed an action against the Board for a sales tax refund in California Superior Court. *Compare* PA 104, ¶ 19 *with* RA 20, ¶ 1. At both the administrative level and in the trial court, Lyon asserted as a ground for its refund claim that section 6007 violated the Commerce Clause of the United States Constitution. PA 102-03, 111.

After a court trial, judgment was entered for Lyon for the entire amount of the refund sought. RA 100-101. In its statement of decision, the trial court relied on this Court's decisions in *Complete Auto Transit, Inc. v. Brady* 430 U.S. 274, 279 (1977), and *Quill Corp. v. North Dakota* 504 U.S. 298, 311 (1992), in determining that section 6007 as applied by the Board to Lyon's eleven drop shipments violated the Commerce Clause. App., 16a-20a.

The Court of Appeal reversed, rejecting the trial court's construction of section 6007 and Lyon's constitutional arguments and directing that judgment be entered in favor of the Board. App, 1a-11a. On the constitutional issue, the appellate court ruled that the trial court committed error in holding that "the drop shipment rule in section 6007 was unconstitutional because it allegedly discriminates against interstate commerce." App., 6a-7a. The Court of Appeal "failed to perceive any unconstitutional discrimination" because the same amount of tax would have been imposed on the sales transaction if it had occurred entirely within California. App., 7a.

In its published decision, the Court of Appeal analyzed in detail whether, under the Commerce Clause, section 6007 created an unconstitutional burden upon interstate commerce. Purporting to apply the four-part test articulated by this Court in *Complete Auto*, the Court of Appeal concluded that "[t]he tax in question here satisfies every one of those conditions" (App., 8a):

> As to the first factor, the goods were stored in a California warehouse and were delivered from there to California consumers, so there was a sufficient nexus with California. Second, there is no unfair apportionment or double taxation; all relevant events occurred in California, and the transactions will be taxed only once by California. Third, there is no discriminatory taxation, because the same tax will be charged on the transactions, and the same tax will ultimately be paid by the retail customers, whether as sales tax or use tax, regardless of the parties' residences. Finally, Lyon concedes the fourth factor is present here, since the tax is fairly related to services provided by the taxing state. Therefore, the

tax in issue here is valid. *Id.* (citing *Complete Auto*, 430 U.S. at 279.)

The California Supreme Court denied Lyon's petition for review on January 14, 1998.

REASONS FOR GRANTING THE PETITION

Petitioner Lyon respectfully petitions this Court to grant certiorari in this case to resolve a recurrent and important federal question that affects the accommodation of state and federal interests under the Commerce Clause of the United States Constitution. No federal precedent presently exists on the specific question presented by this petition. However, the opinion by the Court of Appeal conflicts in principle with numerous decisions of this Court. Hence, review by this Court is necessary to resolve this unsettled question and to correct the erroneous conclusions advanced by the court below.

A. The Drop Shipment Rule as Codified in Section 6007 Presents a Recurrent, Important and Presently Unresolved Federal Question.

The District of Columbia and some forty-five states, including California, have adopted a sales and use tax scheme.[3] Of these, at least nineteen jurisdictions in addition to California have enacted some form of codification of the

---

[3] *See generally* Tax Mgmt. (BNA), *Sales and Use Taxes: Drop Shipment Transactions*, § 1340.05, pp. 1340.05.C.1 - 1340.05.YY.21.C ff.

drop shipment rule.[4] Except for the opinion below, however, no reported case in any of these other jurisdictions has squarely confronted the question presented by this petition. None has thus upheld a statute against a Commerce Clause challenge that, like section 6007, discriminates on its face against local wholesalers who act as drop shippers for out-of-state as opposed to in-state retailers.[5]

---

[4] Connecticut (Conn. Gen. Stat. § 12-407(3) (1997)), the District of Columbia (D.C. Mun. Regs. §§ 414.1, 414.2, 414.7 (1998)), Florida (Fla. Stat. Ann. § 212.06 (West 1997); Fla. Reg. Rule 12A-1.091(10) (1998)), Hawaii (Haw. Rev. Stat. § 237-13 (1997); Haw. Admin. R., Rule § 18-237-13-02 (1998)), Idaho (Idaho Code § 63-3609 (1997)), Kentucky (Ky. Rev. Stat. Ann. § 139.100 (Banks-Baldwin 1998)), Louisiana (La. Admin. Code tit. 47, § 4351 (1997)), Maryland (Md. Code Ann., Tax--Gen. § 11-401 (1998); Md. Regs. § 03.06.01.14 (1998)), Massachusetts (Mass. Gen. L. chs. 64H and 64I (1998)), Mississippi (Miss. Code Ann. §§ 27-65-101-111 (1997)), Nebraska (Neb. Rev. Stat. § 77-2702.13 (1997), Neb. Reg. 1-006 (1998)), Nevada (Nev. Rev. Stat. Ann. § 372.050 (Michie 1997)), North Carolina (N.C. Gen. Stat. §§ 105-164.5, 105-164.8, and 105-164.28 (Michie 1997)), Oklahoma (Okl. Stat. Ann. tit. 68, § 1352(S)(4) (West 1998)), Rhode Island (R.I. Gen. Laws § 44-18-8 (1997)), South Dakota (S.D. Codified Laws §§ 10-45-1 and 10-45-61 (Michie 1997); S.D. Admin. R. 64:06:01:45 (1998)), Tennessee (Tenn. Code Ann. § 67-6-102 (1997); Rule 1320-5-1-.96), Vermont (Vt. Stat. Ann. tit. 32, § 9771 (1997); Vt. Gov't Reg. § 226-6(I)), and Wisconsin (Wis. Stat. § 77.51(14)(d)(1996)). Ten of these states--Connecticut, Florida, Idaho, Kentucky, Nebraska, Nevada, Oklahoma, Rhode Island, Tennessee and Wisconsin--have statutes substantially similar to section 6007.

[5] The highest court in one of the other nineteen jurisdictions has construed a sales tax statute identical to California's in a manner that avoided the potential imposition of an unconstitutional burden on interstate commerce. *See*

(continued...)

Although the question presented remains unsettled, its importance is increasingly recognized. Sales and use tax treatment of drop shipments has generated substantial interest among leading tax commentators.[6] One commentary has questioned whether facial discrimination against interstate commerce in statutes such as section 6007 will pass muster under the Commerce Clause, observing that statutes that impose sales tax on interstate drop shipment transactions "create two classes of taxpayers and treat them differently, based on whether the transaction is interstate or intrastate."[7]

Moreover, virtually all observers recognize that drop shipments are being used more frequently in business as a structural feature that increases efficiency.[8] Drop shipments

---

[5](...continued)
Steelcase v. Crystal (Conn. 1996) 680 A.2d 289. *Cf. VSA, Inc. v. Faulkner*, 485 S.E.2d 348 (N.C.App. 1997) (holding that wholesaler is exempt from liability for drop shipment under state sales tax statute that does not codify drop shipment rule). *See also Steelcase, Inc. v. Director, Division of Taxation* 13 N.J.Tax 182 (1993).

[6] *See, e.g.*, 2 Hellerstein & Hellerstein, State Taxation, *Drop Shipments*, ¶ 18.07B, S18-16 - S-18-18 (1997/9 Cum. Supp.); Tax Mgmt. (BNA), *Sales and Use Taxes: Drop Shipment Transactions*, §§ 1340.01-.03, pp. 1340.01.C - 1340.03.C; H. Michael Madsen & Kimberly L. King, *Interstate Dimensions of the Sales Tax: Third-Party Drop Shipments*, 10 State Tax Notes 1233 (April 22, 1996).

[7] H. Michael Madsen & Kimberly L. King, *supra*, 10 State Tax Notes at 1239 (citing *Armco Inc. v. Hardesty*, 467 U.S. 638 (1984)).

[8] *E.g.*, 2 Hellerstein & Hellerstein, *supra*, ¶ 18.07B, at S-18-18 (1997/9 Cum. Supp.); Tax Mgmt. (BNA), *Sales and* (continued...)

reduce the retailer's cost for inventory and raw materials.[9] Time and money are also saved by the wholesaler's shipping directly to the consumer, as opposed to shipping to the retailer for reshipment to the consumer.[10] Drop shipments are thus becoming an increasingly common feature of modern business practice.

Despite such heightened significance and related concerns about the legality of the drop shipment rule, it is unlikely that a federal court will have an opportunity to address the constitutional issue unless this Court grants review in a state court case presenting the question. Under state tax refund schemes like California's, taxpayers such as Lyon are forced to raise their constitutional defenses to a sales tax deficiency assessment in administrative proceedings before a state administrative agency such as the Board.[11] Where, as here, such defenses are rejected, the taxpayer's sole remedy is to sue for a refund in a suit in which venue lies exclusively in the state trial court.[12]

Accordingly, Lyon's petition represents an opportunity for this Court to resolve an important federal question arising under the Constitution. The constitutionally required result

---

[8](...continued)
Use Taxes: Drop Shipment Transactions, *supra*, § 1340.01, at 1340.01.C; H. Michael Madsen & Kimberly L. King, *supra*, at 1239.

[9] *See* Tax Mgmt. (BNA), *Sales and Use Taxes: Drop Shipment Transactions*, *supra*, § 1340.01, at 1340.01.C.

[10] *See* H. Michael Madsen & Kimberly L. King, *supra*, at 1239.

[11] *E.g.*, section 6902.

[12] *E.g.*, section 6933.

is an important corollary to the rule announced by this Court in *Quill Corp. v. North Dakota,* 504 U.S. 298 (1992), that a state has insufficient nexus to impose sales tax on a retail sale made by an out-of-state retailer not engaged in business in the state. Section 6007 represents California's attempt to circumvent this rule by imposing the sales tax against the wholesaler, who is not a party to the retail sales transaction but who is subject to the state's tax jurisdiction.

B. The Decision by the Court of Appeal Conflicts with this Court's Commerce Clause Jurisprudence.

According to this Court's jurisprudence, the Commerce Clause "has long been seen as a limitation on state regulatory powers as well as an affirmative grant of congressional authority." *Fulton Corp. v. Faulkner*, 516 U.S. 325, 330 (1996). In its negative aspect, the Commerce Clause "prohibits certain state actions that interfere with interstate commerce" (*Quill Corp. v. North Dakota,* 504 U.S. at 309), specifically targeting "economic protectionism--that is, 'regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors.'" *Associated Industries of Missouri v. Lohman*, 511 U.S. 641, 647 (1994) (quoting *New Energy Co. of Indiana v. Limbach*, 486 U.S. 269, 273-274 (1988)). The Court of Appeal misapplied the four-part test articulated by this Court in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, in evaluating whether, under the Commerce Clause, section 6007 creates an unconstitutional burden upon interstate commerce. The consideration of the constitutional issue by the Court of Appeal is seriously flawed in numerous respects.

1. Section 6007 discriminates against manufacturers who do business with out-of-state retailers.

Most important, section 6007 as construed by the Court of Appeal violates the "strict rule of equality" articulated in this Court's Commerce Clause decisions. *Henneford v. Silas Mason Co.*, 300 U.S. 577 (1937). Under this principle of equality, a state cannot, consistent with the Commerce Clause, discourage persons engaged in intrastate business "from plying their trades in interstate commerce" by taxing them more heavily when they do. *Fulton Corp. v. Faulkner*, 516 U.S. at 333. Section 6007 creates such constitutionally impermissible disincentives.

Under the statute, there is a key difference from the perspective of wholesalers and manufacturers like Lyon between drop-shipments involving out-of-state retailers and those involving in-state retailers. In the latter, the California "retailer" is required under sales and use tax law both to include the "sales price" (section 6011) of the goods purchased within its gross receipts (section 6051) and to collect the tax from the purchaser. Section 6203. The "wholesaler" (i.e., Lyon) has no California sales or use tax liability of any kind.[13]

In contrast, in the case of drop-shipments involving out-of-state retailers, the tax, according to the Court of Appeal, is to be paid by the wholesaler (Lyon). The out-of-state retailer is not subject to the tax and has no duty to collect it (*see Quill Corp. v. North Dakota*, 504 U.S. 298), and the wholesaler cannot collect the tax from the purchaser

---

[13] See § 6007 (limiting application of second paragraph of former statute to transactions involving "retailer(s) not engaged in business in this State")(emphasis added). *See also* §§ 6091, 6203, 6401.

because the wholesaler and purchaser are not in privity of contract. Cal. Civ.Code § 1656.1.

The Court of Appeal attempted to sustain the statute's facial discrimination on the ground that the same amount of tax assessed in drop-shipments involving out-of-state retailers is charged in transactions that are completely intrastate.[14] The appellate court went so far as to state that its construction of section 6007 was necessary to prevent "reverse discrimination against out-of-state parties" who otherwise would take advantage of a "gaping loophole . . . in favor of out-of-state intermediaries, that the Legislature validly closed." App. at 9a. This reasoning was erroneous.

First, the fact that the amount of the tax is the same is of no significance under the *Complete Auto* test unless "the events on which the interstate and intrastate taxes are imposed . . . [are] 'substantially equivalent'; that is, they must be sufficiently similar in substance to serve as mutually exclusive 'prox[ies]' for each other." *Oregon Waste Systems, Inc. v. Dept. of Env. Quality*, 511 U.S. 93, 103 (1994) (quoting *Armco, Inc. v. Hardesty*, 467 U.S. at 643). In other words, the tax surcharge must be invalidated unless the State can "sho[w] that it advances a legitimate local purpose that

---

[14] The Court of Appeal attempts to articulate the principle of equality on the basis that "the same tax will ultimately be paid by the retail customers, whether as sales tax or use tax, regardless of the parties' residences." App. at 8a (emphasis added). However, as previously stated (*see* text accompanying footnote 13, *supra*), Lyon, not the retail customers, is required by the Board to pay the sales tax in interstate drop-shipment transactions, which contrasts with the allocation of the tax burden to "retailers" and their customers in wholly intrastate transactions. Accordingly, the factual premise upon which this aspect of the Court of Appeal's decision purports to be based is without foundation.

cannot be adequately served by reasonable nondiscriminatory alternatives." *New Energy Co. of Indiana v. Limbach*, 486 U.S. at 278.

In this case, the Board is unable to make the required showing of no reasonable nondiscriminatory alternative. All of the transactions in question are subject to a legislatively mandated alternative: enforcement of the use tax against the consumers. *See* § 6201 *et seq.*

Also, to sustain the constitutionality of a facially discriminatory statute such as section 6007, "the actual incidence upon the same class of taxpayers is a necessary condition for a finding that two taxes are complementary." *Fulton Corp. v. Faulkner*, 516 U.S. 325, 340, fn. 6 (citing *Henneford v. Silas Mason Co.*, 300 U.S. 577) (emphasis added). For example, in *Armco Inc. v. Harvesty*, 467 U.S. at 642-643, this Court invalidated a wholesale tax, ruling that manufacturing and wholesaling were not sufficiently similar to serve as mutually exclusive "prox[ies]" for each other. *Accord Tyler Pipe Industries v. Dept. of Revenue*, 483 U.S. 232, 244 (1987).

The unconstitutional disparity is even greater under section 6007 than in *Tyler Pipe* and *Armco*. In the case of interstate drop-shipments, only the manufacturer and/or wholesaler who does business with an out-of-state retailer is liable for the section 6007 tax. In contrast, in entirely intrastate transactions, the manufacturer owes no sales tax; the in-state retailer is fully liable for the tax and collects it from the consumer. Hence, the incidence of the tax under section 6007 does not fall on the same class of taxpayers.

Such patent discrimination imposes significant burdens on Lyon. As if to maximize the disruption of Lyon's business, the Board imposes the section 6007 sales tax assessment on the retail sales price charged by Lyon's

customer. Lyon is not itself a party to the retail sales transaction and thus does not ordinarily know what prices its customers (retailers) charge their customers (consumers). The Court of Appeal sought to minimize this onus by observing that "all Lyon had to do was ask" its customers the question when the delivery was ordered. App. at 7a, fn. 3. This additional burden imposed only on interstate sales, however, creates the very disincentives to conducting business in interstate commerce that this Court's decisions condemn.

Because such burdens are unique to drop shipments made to customers of out-of-state retailers, section 6007 violates the "strict rule of equality" mandated by this Court's Commerce Clause decisions.

2. The Commerce Clause prevents the imposition of a tax where, as here, there is no nexus between the retail transaction and the taxing State.

The Court of Appeal's analysis of the nexus requirement--the first prong of the *Complete Auto* test--is also off the mark. Lyon concedes that California has sufficient nexus to impose a tax on the use or delivery of the goods in California, but that is not the tax assessed against Lyon here. The Board's assessment is based on the retail sales transactions occurring between the out-of-state retailers and in-state purchasers.

As the Court observed in *McLeod v. Dilworth Co.*, 322 U.S. 327, 331 (1943), "[t]hough sales and use taxes may secure the same revenues and serve complementary purposes, they are, as we have indicated, taxes on different transactions

and for different opportunities afforded by a State."[15] Moreover, for purposes of imposition of a direct tax such as the sales tax, the constitutional standard requires that a sufficient nexus exist between the state and the activity that the state seeks to tax. *See, e.g., Norton Co. v. Dept. of Revenue* 340 U.S. 534, 537 (1951). The decision in *Quill* establishes that California has insufficient nexus to attempt to tax a retail transaction where the retailer is not engaged in business in the taxing state. The drop shipment rule, which assesses a tax upon that same retail sale, thus fails the first prong of the *Complete Auto* test.

3. As applied, section 6007 is unconstitutional because it creates the potential for multiple taxation.

Finally, and contrary to the reasoning of the Court of Appeal, assessment of sales tax against Lyon violates the second prong of *Complete Auto* proscribing unfair apportionment. Fair apportionment is satisfied where a tax is "internally consistent" such that "the imposition of a tax identical to the one in question by every other state would add no burden to interstate commerce that intrastate commerce would not also bear." *Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 185 (1995) (upholding an Oklahoma tax on the sale of bus tickets for travel originating in the state because if every state enacted an identical tax, each sale would still only be taxed once). By artificially imposing a tax upon Lyon at the wholesale level, however,

---

[15] *See* Rotunda & Nowak, *Treatise on Constitutional Law: Substance and Procedure*, § 13.6, at 272 (2d ed. 1992) (discussing *McLeod v. Dilworth* and observing that "the Court refused to accept the contention that since a use tax would have been valid in the circumstances, a sales tax should be accepted as permissible in view of the fact that the economic effect would be the same").

the Board creates the risk of multiple taxation in contravention of the fair apportionment requirement.

In the present case, the tax assessed against Lyon under section 6007 is subject to being imposed on other parties involved in the drop shipments. If the retailer's customer to whom Lyon makes the shipment is not itself a "consumer" but is actually a retailer, the sales tax will be imposed on the retailer's customer as well as Lyon, the drop shipper. Likewise, even if Lyon delivers goods to a consumer in California pursuant to a drop shipment and eventually pays a sales tax assessment, the consumer's use tax liability (section 6202) would be discharged only in theory because it has no way of knowing that the sales tax has been paid.[16] Such differential treatment exposes the unconstitutionality of section 6007 under the second prong of the *Complete Auto* test as well.

---

[16] Under the California tax regime, a consumer's use tax liability is not extinguished without evidence of a receipt establishing that sales tax has been paid (*id.*) or other satisfactory evidence that sales tax has been paid. Section 6401. Here, the Board admits that it has not notified the consumers in the eleven drop shipment transactions that Lyon paid the sales tax and likewise admits that it has no knowledge or information that anyone else has notified the consumers. PA 69, 73-74.

CONCLUSION

For these reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

MURPHY, HUPP, FOOTE, MIELKE AND KINNALLY
PATRICK M. KINNALLY
8 East Galena Boulevard
Suite 202
P.O. Box 5030
Aurora, IL 60507-5030
Tel.: (630) 844-0056

PILLSBURY MADISON & SUTRO LLP
CRAIG E. STEWART
Counsel of Record
THOMAS V. LORAN III
DAVID P. JEDRZEJEK
235 Montgomery Street
Post Office Box 7880-94120
San Francisco, CA 94120
Tel.: (415) 983-1000

Counsel for Petitioner

April 14, 1998